

Distribution

For

Remarks of
Chairman James J. Hoecker
Federal Energy Regulatory Commission

**"The New Economy of Competitive Energy
Providers Wants You -- To Act Now!"**

EEI Board of Directors Meeting
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This is the third time in three years I have visited with the leadership of EEI. I appreciate the invitation and President Montoya's gracious introduction. And, now that the Commission has gone on record with what it perceives to be the next (but probably not the last) big phase of wholesale electric restructuring -- regional transmission organizations -- I need not spend our time together this morning trying to persuade you that change is coming or why, or that the industry should support a particular vision of the 21st century power market, or

that the Commission is determined to follow through with the fundamental propositions underlying Order No. 2000. You can read that order and the proverbial tea leaves as well as I can. In fact, I submit to you that what the Commission is working so hard to accomplish in this matter is pretty straightforward; we want a clearer organization, a greater degree of transparency, and a crisper pace within a restructuring process that is at least as much driven by market forces, fuel prices, technology, reliability concerns, and corporate consolidation, as it is by regulatory policy. We cannot afford to wait for federal legislation, although it would be helpful.

Post-Order No. 2000, the Commission is engaged in an administrative process -- a kind of once-in-a-lifetime offer -- that leaves ample opportunity for transmission owners and other market participants to put their region-specific fingerprints on the market structures of the future and to hasten an

evolutionary process that I feel will only get more painful financially the more time it takes. You and I -- utilities and the FERC -- are both committing considerable resources to this effort, I know. The dynamic competitive environment we are creating is challenging and will prove to be rife with both risk and reward. As I stand here today, however, I feel like we are kindred souls in the sense that competition and politics may make lame ducks out of all of us. But that's all right if the public interest gets served.

Looking around at the changing ranks of management in the investor-owned community and the diversity of views you espouse on things like RTOs, it would be fruitless for me to try to convince you that, of all the potential courses of action the Commission might have selected in advancing the public's interest in reliable and reasonably priced electric power, it selected exactly the right one. I like it but that's beside the point. The EEI membership has multiple

perspectives on Order No. 2000 and what can be done with it. This is both predictable and appropriate, given the choices being made by your companies in today's business environment. Back in 1993 when I first joined the FERC, neither you nor I probably expected to witness this divergence of opinion among utilities. But here we are.

This morning, rather than rummage through the details of our RTO policies, I want to make some general observations and then take questions. First, let me assure you that the Commission does not have its eyes wide shut about the risks inherent in this transition, about the difficulties faced in some regions preserving constructive relationships with state agencies that see "local" utility assets migrating into the broader competitive market, about the often-daunting prospect of abandoning guaranteed rates of return for competition. We understand the coming battles over market share and the escalating

demands of risk management, the requirements of the digital economy and the craziness on Wall Street with investors fleeing value stocks for the dot-com's. We do not discount concerns about maintaining or enhancing shareholder value during a time of transition when uncertainty may tend to depress stock values. Nor are we blind to the complexities of redeploying assets out of the vertically integrated structure with which we are so familiar.

The choices for you may be difficult but at least they are increasingly obvious. I find that, even within the ranks of IOUs, it makes a difference if one views the future from the ISO-oriented Northeast or West, the transo-focused Southeast, or the "AC/DC" middle of the country. Those who prize having both the management and ownership of transmission in one entity and that see the motivation for business performance, profit optimization, and transmission expansion as the basic driver for successful grid management will face

their toughest challenges: timeliness and scope of the organizational effort; making a real commitment to reliability over other considerations; and success in stroking investment bankers and the tax code. Should we simply sell our transmission, spin-off to shareholders, IPO, joint venture, or form an umbrella LLC?

On the other hand, those who value speed in development, stakeholder input, regional collaboration, reliability, and circumnavigating the most troublesome aspects of the tax laws -- in other words, an ISO -- face distinctly different challenges: including how to gather a multiplicity of existing companies, market participants, and other parties under one tent, with workable governance and coherent business and operational plans; how to address some serious credibility issues when it comes to escaping the influence of state self-interests; how to motivate management to maximize efficiency and minimize costs;

how to attract capital and expand the grid where necessary; and how to reduce start-up costs. In every instance, leaders of these efforts will confront the strategic self-interest of neighboring utilities, the plans of state regulators, and the FERC. They must address how the change imperative affects their own company cultures and how to ensure that their own employees not only survive but prosper. Is that enough for you? Frankly, it makes one's brain hurt.

You can do it! The Commission truly wants you -- meaning the market -- to make those decisions, naturally within the metes and bounds of the public policies we have laid out. The Commission has put its cards on the table and it is time the industry rolled over a few of its own. These are months of historic importance for your business and, whether they realize it or not, for American energy consumers. Although we still see utilities whose affiliates are benefitting from open markets within existing ISOs while they

circle the wagons in their own service territories, these companies are, fortunately, diminishing in number. I have always found their credibility in advising against aggressive promotion of competitive regional markets across the country to be extremely low. Because, since Order No. 888, there is no longer a single IOU view of the future of the electric business, transmission probably lacks the strategic importance it once had. With merchant generation, power marketing and brokering, power exchanges, risk management services, and end-use power sellers loose in the land, a free-standing transmission industry is no longer sheer fantasy. It is now a public necessity.

In short, I believe that any delay in taking steps to manage transmission as a separate business line and to deal with the consequences of that reality will place shareholder value in jeopardy. We must both -- regulator and regulated company -- think strategically. We must both make timely moves. It takes leadership.

I know you have it. Replay the generation divestiture phenomenon in your heads for a moment. I won't ask how many of you thought John Rowe was one taco short of a combination plate when he placed all of NEES' generation on the block. It was an historic first move that changed even the regional market. Of course, no good deed goes uncopied and we might reasonably expect that the potential for sales of utility assets well above book value will evaporate sooner or later.

So, I am urging you to confront and help mold the inevitable. Bulk power competition is coming to the grid nearest you! What I am hearing about the participation of investor-owned utilities in our RTO collaborative sessions is not only encouraging, but often downright startling. In nearly every region, transmission owners are in effect saying to us, let's work out how we can get this done. Public power is knocking on the door. Consumer and environmental groups are getting involved. And even our flagship

federal utilities (BPA in particular) are thinking about their markets and operations very differently than they were only a year or two ago. Nearly 1500 high-level participants have attended our first four workshops and the discussions have been frank but, most of all, pragmatic and goal-oriented. For better or worse, my expectations for October and beyond are rising!

You might nevertheless ask, will the Commission walk the walk as well as talk the talk. We are challenged -- by our own objectives and by you -- to perform. When a staff witness cranks out a credible DCF analysis that yields an equity return of 10% or less, you may find we have our own credibility problem. Naturally, rewards follow actual risks when it comes to setting returns. DCF takes real market risks and capital costs into account. Its use in a non-RTO environment is an acceptable way to capture the

financial challenges of normalcy. But, in Order No. 2000, we acknowledge that what we're asking is not run-of-the-mill efficiency improvements or corporate change. This is a rule for a fundamental transition to a better market structure. So, when we offered pricing reform, we meant it. When you argued that grid expansion or other relief for congestion may be needed, we heard you. We will expect you to develop regional markets that are big enough and efficiently controlled to meet the standards of our order, but we are also prepared to promote markets that are supported by financially viable transmission entities and adequate physical plant. There is no reason that transmission can't be a viable, even a growth, industry. Efficiency and reliability and the public interest command it.

What we want in return, even in regions where ISOs -- those RTO wannabes -- now operate, is a commitment to real action. We are not interested in changes that are just incremental steps laden with

promises for the distant future. I have heard it often and I do expect that smaller RTOs will grow into bigger ones. Moreover, I do think that, at least in theory, "seams" solutions can add transparency and eliminate barriers in even the most gerrymandered RTO-based market. But, unless I miss my guess, the Commission will find it very hard to bet on the come, at least not without firm plans and commitments that make the competitive future of the bulk power market clearly a large, efficient, transparent, and barrier free market environment.

In the final analysis, for the agency to make the judgments that you and other market participants and the economy itself need us to make, the industry must work with us, explain its challenges and impediments, listen to our concerns, and then act as boldly as it can. First and foremost, it must show us an RTO. To my way of thinking, those who really step forward on a timely basis will be rewarded, by the Commission to a

degree, but mainly by the market -- which offers to first movers the greatest compensation.

Thank you.